US Public Pension Funds and CSR

Responsibility for the developing world?


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The particular feature of public pension funds, their membership base being comprised of public-sector labour unions, has facilitated an active relationship between its shareholders (labour) and corporate executives through the promotion of good corporate governance principles in the United States (Ghilarducci 2004; Hawley/Williams 2000; Hebb 2001; Blackburn 2003) (1). Unlike private pension funds, CalPERS has attempted to balance social including environmental and financial issues vis-à-vis its investment decisions and strategies.

California Treasurer and CalPERS Board Member, Phil Angelides, argues that ‘enduring value’ should act a guiding principle for investments as opposed to short-term economic thinking. By this Angelides means ‘that the current laissez-faire, let-‘er-rip system damages important social values – equitable treatment of workers, the environment and other commonly shared public assets – and that both workers and retirees (and the state taxpayers who put up the money for public pension funds) have a strong self-interest in husbanding the distant future: a healthy society and strong economy for themselves and their families’ (Greider 2005).

Extended understanding of corporate governance

By emphasising socially responsible investing practices, CalPERS employs an extended understanding of corporate governance that transcends the short-term oriented behaviour and narrowly defined confines of pure fiduciary responsibilities aimed at ensuring that corporate management and the Board of Directors work toward the Anglo-American principle of maximising shareholder value (Lazonick/O’Sullivan 2000; OECD 2004; Soederberg 2004a).

CalPERS’ extended view of corporate governance is evident in its Permissible Country Index (herewith PCI), which was devised in 1987. The PCI presents itself as a highly dynamic initiative that interacts and changes with the demands of the ever-changing global economy. It is worth emphasising here that the PCI has teeth. Amid the height of Enron-style scandal in the US CalPERS ‘announced that it was going to pull out of all its investments in Thailand, Malaysia, Indonesia and the Philippines mainly because of concerns about social conditions in these countries’ (Blackburn 2003: 516; Greider 2005).

CalPERS AND THE PCI

The economic power behind the 3 largest public sector pension funds in the United States are evident by their vast holdings: CalPERS manages over 182 billion Dollar of assets (CalPERS 2005b), the California State Teachers Retirement System, the country’s second largest fund, holds another 125 billion Dollar in assets, whilst the third largest, New York State Common Retirement Fund, represents 121 billion Dollar in assets (Greider 2005). While the majority of CalPERS’ assets are invested on a long-term basis in US corporations, the fund does hold investments in emerging markets.

In February 2005, for instance, the fund held $3.9 billion in assets in emerging markets. This trend will persist, as the role of emerging markets vis-à-vis production facilities and consumer markets continue to flourish (World Bank 2005a+b) (2). The surge of foreign financial flows to the ‘emerging markets’ also coincided with the low interest rates in the G-7 countries during the early 1990s, which was brought about by one of the deepest recessionary environments in post-war period, outweighed official development assistance (see Table 1).

Table 1: Financial Flows to Developing Countries 1990-2004

Source: World Bank (2005b)
It is against this backdrop that the PCI was forged and became an important tool for monitoring performance and enhancing value of investments abroad. The Index should be regarded as a dynamic document that seeks to be sensitive to changes and challenges in the global investment environment. It was not until 1999 in the wake of the East Asian crash of 1997 that the Investment Committee at CalPERS requested that Wilshire Associates undertake ‘a complete review of the analysis and looked to expand it since more information regarding countries and markets has become available’ (Wilshire Consulting 2005: 3).

In the light of the losses incurred by the Enron and subsequent debacles in the US and the ensuing loss of investor confidence, the CalPERS’ Investment Committee sought to fine-tune the PCI by adding two new features to the Index as well as a broader treatment of political risk (Wilshire Consulting 2005).

Measuring ‘Enduring Value’

The first country factor of the PCI is political stability, comprised of two parts: a macro-factor and several sub-factors. Political stability, the macro-factor, refers to progress in the creation of basic democratic institutions and principles, such as guaranteed elimination of human rights violations, and a strong and impartial legal system. Political stability is seen as vital components in guaranteeing the development of a free market in the Third World, which in turn will attract and retain long-term capital. There are several sub-factors that further define political stability: civil liberties, independent judiciary and legal protection, and political risk (Wilshire Consulting 2005).

It is worth emphasising that the ‘credible independent’ third-party sources that are used to evaluate these sub-factors is the Freedom House rankings, which are published on an annual basis. For the most part, the Freedom House’s findings are guided by the Universal Declaration of Human Rights (Freedom House 2005). It should be noted that the same criteria supplied by the Freedom House is used by President George W. Bush’s highly controversial ‘global development compact’: the Millennium Challenge Account (cf. Soederberg 2004b).

Judiciary and legal protection sub-factor

To determine the independent judiciary and legal protection sub-factor, Wilshire draws on the Contracts and Law Sub-Index that is published annually in the Global Competitive Report, which is affiliated with the World Economic Forum. Lastly, for the political risk sub-factor, Wilshire draws on the risk ranking published in the International Country Risk Guide of a private consultancy firm, PRS Group, which caters to top Fortune 500 companies. Similar to the other PCI factors, each of these three sub-factors is scored out of three. The highest score is three (good) and the lowest is one (poor). For a country to remain on the investable market list, they must achieve a passing score of two.

The second macro-factor is transparency. Wilshire sees this factor as comprising primarily financial transparency, but including elements of a free press necessary for investors to have truthful, accurate and relevant information on the conditions in the countries and companies in which they are investing.’ (2005: 6). The transparency factor includes four sub-factors: freedom of the press, monetary and fiscal transparency, stock exchange listing requirements, and accounting standards (2005: 6-7). Productive labour practices comprise the third macro-factor. To assist in the evaluation of this macro-factor, Wilshire Consulting identified a credible third party: Verité is a non-profit research organization based in Amherst, Massachusetts.

Role of the International Labour Organisation

As Wilshire states, in the attempts to facilitate of economically-productive labour practices, markets shall be evaluated based on their ratification of and adherence to the principles laid out by the International Labour Organization (ILO), which cover labour rights and prohibitions on abusive labour practices, and the degree of effectiveness of implementation through relevant laws, enabling regulations and their degree of enforcement through the judiciary process’ (2005: 7).

The Productive Labour Practices macro-factor is accompanied by the following four sub-factors, which total to a maximum of 40 points per country: ILO Ratification, Quality of Enabling Legislation, Institutional Capacity, and effectiveness of implementation. Moreover, these sub-factors are more heavily-weighted toward the quality of enabling legislation and the effectiveness of implementation (ibid.). Drawing on the ILO, Wilshire defines the sub-factor of ‘effectiveness of implementation as: ‘The procedures that exist for enforcement and monitoring of enforcement of laws in the convention areas and evidence that exists that these procedures are working effectively; the existence of a clear grievance process; evidence that workers and/or unions utilize this grievance process; the extent to which penalties provided for in the laws are levied; and the evidence that penalties have deterrence value’ (Wilshire Consulting 2005: 8).

For CalPERS, the PCI is a useful rating-system in which to gauge not only company level adherence to good corporate governance practices, but also a developing country’s commitment to ensuring an institutional framework that will support the
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‘proper’ functioning of equity investments. This is an important
point as it reflects the nature of the PCI as a tool to protect wor-
kers’ delayed wages by improving economic efficiency, rather
than radical ideas of social justice aimed at mitigating and/or
reducing harmful effects of economic exploitation rooted in ca-
pital accumulation, such as the low wages, long working days,
and lack of adequate health and social benefits (Altvater/Mahn-
kopf 2002; Harvey 2001).

Relatedly, the reformist nature of the PCI also rests on a key
assumption that the links between economic efficiency and po-
litical democracy are historical and logical trends. Bob Jessop
identifies Milton Friedman, as one of the main proponents of
this assumption. Friedman argues that the typical state of man-
kind is tyranny, servitude, and misery and that the nineteenth
and early twentieth century in the Western world are remarka-
able exceptions to the general trend that the free market and the
development of capitalist institutions are necessary conditions

The issue that is neglected in this assumption, as Jessop re-
ments us, is that democracy secures capitalist interests by en-
suring that the working class can be legitimately subjected to
the exploitation of capital – or, ‘where exploitation takes the
form of exchange, dictatorship tends to take the form of demo-
cracy’ (1983: 277). CalPERS and the ‘independent’ third parties,
upon whom it draws its expertise, are not alone in sharing this
correlation between political democracy and free market en-
prise.

**Questionable knowledgebase**

Just as the above assumption is neither neutral nor a natu-
ral occurrence, the knowledge base underpinning the PCI must
also be put into question. It is worthwhile highlighting that Wilsh-
hire Associates do not determine which factors and sub-factors
comprise the PCI; instead, they are determined by the CalPERS
Board of Directors, although the revised PCI was initiated by
both the Treasury Department of California and the former CEO
of CalPERS, Sean Harrigan (3). According to a senior associate
at Wilshire, it is the consultancy firm’s job ‘to find appropriate,
credible independent third-party sources that evaluate the fac-
tors and sub-factors’(4). One needs to recognise that despite
Wilshire’s assertion that ‘credible independent third-party sour-
ces’ are used in the evaluation process of these factors and sub-
factors, knowledge is not an objective abstraction that is devoid
of a material basis.

As Susan Strange argues, ‘knowledge structures exist which
have the effect of valuing or devaluing different forms of know-
ledge.’ Moreover, a knowledge structure ‘determines what know-
ledge is discovered, how it is stored, and who communicates it
by what means to whom and on what terms’ (1988: 115-117). As
mentioned above, in 2002, the year that Wilshire devised the ex-
panded PCI detailed above, CalPERS decided to pull out of all
its investments in Thailand, Malaysia, Indonesia and the Philip-
ippines. However, after intense lobbying by the Philippine go-
vernment and community living in the United States, CalPERS
reversed its decision in May 2002.

In February 2003, Wilshire Associates, once again, advised
CalPERS to divest from its Philippine holdings. Instead of heed-
ning this advice, CalPERS management devised a ‘cure period’,
which refers to 1 year of grace before CalPERS liquidates its in-
vestments in any emerging market that slips out of public pen-
sion funds’ permissible list. In February 2004, Wilshire once
again advised CalPERS to exit the Philippines, as it did not meet
the criteria set out by the PCI, despite the cure period.

**Enduring Value in the Developing World**

This brief account has sought to provide a broad and criti-
cal overview of CalPERS’ attempt at ethical investment practi-
ces in the Third World. The PCI, despite its limitations, does
contain potential to challenge the increasing power of corpo-
rations and finance over everyday lives in the global North and
South. Although, CalPERS current investments in the develo-
ping world are quite small (3.9 billion Dollars) compared to
over 279 billion Dollars in private capital flows, there are at le-
ast two important global trends, both of which suggest that
struggles for social justice via international investment practi-
ces could gain critical levels of momentum in the near future
(Bose 2005).

First, the money managed under the PCI initiative repre-
sents part of a larger ethical fund industry, which generates
approximately 2.4 trillion Dollars, indicates that many invest-
ors and savers are beginning to feel more sympathetic to the
critiques against neoliberal-led globalisation and they are able
to back up these sentiments with money. Second, at the inter-
national level, workers’ deferred wages amount to approxima-
tely 13 trillion Dollars (Guinan 2003). However, before Cal-
PERS could act as the model ethical investor, it should move
toward a more radical approach in ensuring social accounta-
bility that rests on more critical understanding of the role of
capital accumulation in the Third World, as well as the advan-
ced industrialised countries.
Literature

Notes
(1) This paper forms part of my forthcoming book Social Accountability versus Corporate Governance: Understanding and Transcending the Construction of a False Binary.
(2) Confidential interview staff member of the Council of International Investors, Washington, DC on 13 May 2005.
(3) Confidential interview with representatives from the Treasury Department of California on 6 May 2005.
(4) Confidential e-mail exchange with a Senior Associate at Wilshire on 21 June 2005.

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